United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-5001

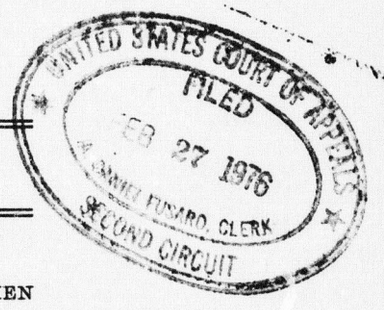
To Be Argued By:
ROBERT S. COHEN

United States Court of Appeals
FOR THE SECOND CIRCUIT

Docket No. 76-5001

IN THE MATTER
of
MEDICAL ANALYTICS,
Debtor.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK



BRIEF FOR APPELLANT

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ISSUE PRESENTED

Whether the six month limitation on actions to set aside the confirmation of an arrangement in bankruptcy on the grounds of fraud set forth in 11 USC § 786 bars proceedings commenced within six months from discovery of the fraud but seven months after the date of confirmation of the arrangement.

The Court below affirmed the Bankruptcy Court's dismissal of the petition on the grounds that it was absolutely time-barred.

STATEMENT OF THE CASE

A. Nature of the Case

This is an appeal from the order of the District Court, Conner, J., affirming the dismissal on motion by the Bankruptcy Court, Ryan, J., of the petition brought by appellant (hereinafter "Medical") to set aside the confirmation of an arrangement in bankruptcy on grounds of fraud.

By order dated May 16, 1975, the Bankruptcy Court granted the motion of appellee (hereinafter "MetPath") to dismiss Medical's petition on the grounds that Medical's action was time-barred as a matter of law by operation of 11 USC § 786. (A copy of the order appears in the Joint Appendix at p. A-54.) No opinion setting forth the basis of that decision was issued by the Bankruptcy Court.

By memorandum and order dated December 1, 1975, the District Court affirmed Judge Ryan's ruling that the petition was time-barred by operation of 11 USC § 786. (A copy of the District Court's order appears in the Joint Appendix at p. A-57.) The District Court affirmed the ruling below on the ground that, notwithstanding the fact that the petition was filed within six months after the discovery of the fraud, it was untimely because it was not filed within six months after confirmation of the arrangement.

B. Statement of Facts

For purposes of this appeal the facts are simple and undisputed. Medical filed a petition in bankruptcy under Chapter XI of the Bankruptcy Act on March 6, 1973. (Appendix

p. A-12). Subsequently, Medical and MetPath entered into a Plan of Arrangement (hereinafter the "Plan") pursuant to which MetPath, a corporation engaged in the same business as Medical (the operation of medical laboratories), acquired Medical's customer lists which were its principal assets. (Appendix p. A-12 to A-13). In exchange, MetPath undertook to provide money to Medical which Medical's president at the time Raymond Rose (hereinafter "Rose") and MetPath represented would be sufficient to fund the Plan and restore Medical's economic health. (Appendix p. A-12 to A-15). The Plan was confirmed by Bankruptcy Judge Edward Ryan on May 2, 1974. (Appendix p. A-11 and A-20 et. seq.).

In September, 1974, Robert Abel (hereinafter "Abel"), who was elected Medical's president after the Plan was made first became aware that MetPath and Rose, who had left Medical's employ to work for MetPath (this was not disclosed at the time) had fraudulently procured the adoption and confirmation of the Plan by, among other things:

> (a) Falsely and fraudulently representing that the proceeds from the sale of certain assets to MetPath were sufficient to meet the Plan and that additional proceeds would enure to the Company; and
>
> (b) Falsely and fraudulently concealing at the time the Plan was being formulated and adopted that they made an arrangement for MetPath to employ Rose at a substantial salary plus other emoluments; and
>
> (c) Falsely and fraudulently representing that Medical would be a viable entity after discharge.

After trying to unsuccessfully resolve the matter without litigation, (Appendix p. A-8) Medical by way of petition and motion filed December 4, 1974, (seven months and

two days after confirmation) commenced the preceding below to revoke the confirmation. (Appendix p. A-7 - A-8; and A-11 through A-19).

THE STATUTE AT ISSUE

Title 11 USC § 786:

Sec. 786. Fraud in procuring arrangement.

If, upon the application of parties in interest filed at any time within six months after an arrangement has been confirmed, it shall be made to appear that fraud was practiced in the procuring of such arrangement and that knowledge of such fraud has come to the petitioners since the confirmation of such arrangement--

(1) if the debtor has been guilty of or has had knowledge thereof before the confirmation and has failed to inform the court of the fraud, the court may set aside the confirmation and thereupon, (a) where the petition was filed under section 721 of this title, reinstate the pending bankruptcy proceeding, adjudge the debtor a bankrupt, if he has not already been so adjudged, and direct that the bankruptcy proceeding be proceeded with, or (b) where the petition was filed under section 722 of this title, reinstate the proceeding, adjudge the debtor a bankrupt, and direct that bankruptcy be proceeded with pursuant to the provisions of this title; or

(2) the court may set aside the confirmation, reinstate the proceeding under the petition filed under this chapter, and hear and determine applications for leave to propose, within such time as the court may fix, alterations or modifications of the arrangement for the purpose of correcting the fraud; or

(3) the court may reinstate the proceeding under the petition filed under this chapter and modify or alter the arrangement for the purpose of correcting the fraud, but may not materially modify or alter the arrangement adversely to the interests of any party who did not participate in the fraud and who does not consent to such modification or alteration, or to the prejudice of any innocent person, who, for value, subsequent to the confirmation, acquired rights in reliance upon it.

ARGUMENT

By Federal Decisional Law, 11 USC § 786, A Statute Of Limitations Which Operates So As To Bar A Claim Based On Fraud Runs From The Time The Fraud Is Discovered.

A. Statutes specifically designating the event from which the limitation runs are held by the federal courts to run from the discovery of the fraud.

In Bailey v. Glover, 88 US 342, 22 L.Ed. 636 (1875), the Supreme Court first enunciated the "equitable doctrine," still vital today, that a statute of limitations which operates so as to bar a claim based upon fraud runs from the time the fraud is discovered. In Bailey, the assignee of a bankrupt sued to set aside a fraudulent conveyance. The following statute of limitations was pleaded in defense:

> The Circuit court shall have concurrent jurisdiction of all suits at law or in equity, brought by the assignee against the person claiming an adverse interest; or by such person against the assignee, touching the property of the bankrupt transferable to or vested in the assignee; but no suit at law or in equity shall in any case be maintainable by or against such assignee, or by or against any person claiming an adverse interest touching the property or rights of property aforesaid in any court whatsoever, unless the same shall be brought within two years from the time of the cause of action accrued for or against such assignee. 22 L.Ed. 636 at pp. 637-38 (emphasis added).

Weighing the importance of a speedy disposition of bankruptcy proceedings against the fraud-prevening purpose of statutes of limitations, the Court held:

> ... [I]n construing this Statute of Limitations passed by the Congress of the United States as part of the law of bankruptcy, we hold that when there has been no negligence or laches on the part of the plaintiff in coming to the knowledge of

> the fraud which is the foundation of the suit, and when the fraud has been concealed, or is of such character as to conceal itself, the statute does not begin to run until the fraud is discovered by, or becomes known to the party suing, or those in privity with him. 22 L.Ed. 636 at p. 639.

The Court set forth the basis for this holding as follows:

> ... This [equitable doctrine mandating that a statute of limitations which operates so as to bar an action based upon fraud begins to run upon discovery of the fraud] is founded in a sound and philosophical view of the principles of the Statutes of Limitation. They were enacted to prevent frauds; to prevent parties from asserting rights after the lapse of time had destroyed or impaired the evidence which would show that such rights never existed, or had been satisfied, transferred or extinguished, if they ever did exist. To hold that by concealing a fraud, or by committing a fraud in a manner that it concealed itself until such time as the party committing the fraud could plead the Statute of Limitations to protect it, is to make the law which was designed to prevent fraud, the means by which it is made successful and secure. And we see no reason why the principle should not be as applicable to suits tried on the common law side of the court's calendar as to those on the equity side. 22 L.Ed. 636 at p. 638.

In 1918 the Court applied the Bailey doctrine to a statutory six year limitation on an action to vacate and annul a patent. Exploration Company v. United States, 247 US 435, 62 L.Ed. 1200 (1918). Unlike the statute at issue in Bailey which fixed the date at which the limitation began to run at the accrual of the cause of action, the statute in Exploration limited an action to the specific event of the issuance of a patent. The statutory limitation asserted in Exploration reads:

> ... [S]uits by the United States to vacate and annul any patent heretofore issued shall only be brought within five years from the

> passage of this Act, and suits to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents. 247 US 435 at 445 (emphasis added).

Similar to the statute at bar, a literal reading of the statute in Exploration reduced the calculation of the time from which the limitation ran to an unequivocal six years from a designated event. By explicit statutory terms, the clock started running on the date of the issuance of the patents. Similarly, at bar, by explicit statutory language, the clock starts running on the date an arrangement in bankruptcy is confirmed. 11 USC 786. Setting forth the recognized authority and sound basis for Bailey, the Court held the Bailey doctrine applicable to statutes so specifying the time at which the statute begins to run. The Court stated:

> It is the contention of the appellants that the statute was intended to bar all actions after six years from the date of the issuance of the patent.... We are unable to agree with this contention. We think the true rule is established in federal jurisprudence by the decision of this Court in Bailey v. Glover. 247 US 435 at 446 (emphasis added).

By implication, the Exploration court extended Bailey to statutes not specifically excluding application of the rule. The Court noted the Bailey rule was in effect at the time Congress enacted the statutory limitation at issue and presumed Congressional enactment of the limitation with that rule in mind. Implying that Congress must have intended application of Bailey, the Court stated:

> We cannot believe that Congress intended to give immunity to those who for the period named in the statute might be able to conceal their fraudulent action from the

knowledge of the agents of the Government.
247 US 435 at 449.

At the time the statutory limitation at bar was enacted, and still today, Bailey and its progeny control judicial application of statutory limitations which operate so as to bar claims based upon fraud. As the Exploration Court held, so should this Court. Indeed, Congress could not have intended to allow arrangements in bankruptcy procured by fraud to stand unchallenged merely because the defrauders are able to conceal the fraud or their fraud conceals itself for six months from the date of confirmation of those arrangements.

Again faced with the issue, the Supreme Court extended the application of the Bailey rule to "every federal statute of limitations." Holmberg v. Armbrecht, 327 US 392 at 397, 90 L.Ed. 743 (1946). The Holmberg plaintiff brought an action to enforce certain liabilities under the Federal Farm Loan Act against a defendant who fraudulently concealed his ownership and interest in certain stock. The applicable state statute pleaded limited the commencement of such actions to ten years. The proceeding was concededly commenced after the limitation's literal expiration. Notwithstanding the apparent specific statutory limitation, the Court refused to bar the action, holding that under controlling federal law, the statute of limitations in an action for fraud does not begin to run until the fraud is discovered. The Court stated:

> ... [T]his Court long ago adopted as its own the old chancery rule that where a plaintiff has been injured by fraud and remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered though

> there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party. 327 US 392 at 397 (cites omitted).

As if to settle the issue once and for all, the Court stated that the Bailey rule is applicable to "every federal statute of limitation." 327 US 392 at 397. No exclusions were made as the Court below did in the case at bar. Where a federal enactment contains a specific limitation, the limitation does not begin to run until the fraud which forms the basis of the action is discovered. In the Court's words:

> This equitable doctrine [the limitation runs from the discovery of the fraud] is read into every federal statute of limitation. If the Federal Farm Loan Act had an explicit statute of limitation for bringing suit under § 16, the time would not have begun to run until after petitioners had discovered, or had failed in reasonable diligence to discover, the alleged deception by Bache which is the basis of this suit. 327 US 392 at 397 (emphasis added).

Similarly, the explicit statute of limitation for filing an application pursuant to § 786 of the bankruptcy laws should not be held to run until after the applicant has discovered, or had failed in reasonable diligence to discover the fraud which is the basis of the application.

Where this Court and the District Court for the Southern District of New York has previously ruled on the applicability of the Bailey rule to an explicit statutory limitation on a proceeding under the bankruptcy laws, both have applied Bailey on the basis of prior authority and sound principal. In Austrian v. Williams, 80 F. Supp. 437 (S.D.N.Y. 1948), a reorganization trustee brought suit pursuant to section 2 of the Bankruptcy Act for, inter alia, an accounting by the

bankrupt's former fiduciaries. Among the defendants were former officers and directors of the bankrupt who allegedly used their fiduciary positions for "personal and selfish purposes" and "in complete disregard of the interests and welfare" of their fiduciary duties and the debtor.

In answer, defendants pleaded the statutory limitation set forth at section 11 subdivision e of the Bankruptcy Act, 11 USC § 29, sub. e, which reads:

> A receiver or trustee may, within two years subsequent to the time of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. 80 F. Supp. 437 at 441.

Despite the explicit statutory language designating the time from which the limitation starts to run, the Court held Bailey applicable so as not to bar the action. Indeed, because of the explicit statutory language, the Court was constrained to note that:

> Section 11 sub. e, if applicable, by its explicit language seems to bar this suit. 80 F. Supp. 437 at 441.

The Court, however, found section 11 sub. e no obstacle to the maintenance of the suit. Citing Bailey and Holmberg, the Court continued:

> Section 11, sub. e, ... is a federal statute, and it has long been the rule that, where the suit seeks to obtain relief against a fraud, the bar of any applicable federal statute of limitation does not begin to run until the fraud is discovered or becomes known to the parties suing, or to those in privity with them ... (cite omitted). As stated by Justice Frankfurter in Holmberg v.

> Armbrecht, 327 US 392 at page 397, 66 S.Ct. 582, 585, 90 L.Ed. 743, 162 A.L.R. 719: 'This equitable doctrine is read into every federal statute of limitation.' 80 F. Supp. 437 at 441.

Upon consideration of the same issue, this Court in Dabney v. Levy, 191 F.2d 201 (2nd Cir. 1951) and the Fifth Circuit Court of Appeals in Hooper v. Mountain State Securities Corp., 282 F.2d 195 (5th Cir. 1960) cert. den. 365 US 814, 5 L.Ed. 2d 693, applied the Bailey doctrine, approving both prior authority and the principals upon which that authority is based. In Dabney, this Court noted that the Supreme Court:

> [I]nterpreted the precursor of this act [11 USC § 29 sub. e] in 1874 to mean that in cases of 'fraud' the trustee always has two years from the time when he learns of the 'fraud'. 191 F.2d 201 at 204.

Citing Bailey with approval this Court stated:

> '[W]here the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud has been discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it. 191 F.2d 201 at 205 (cite omitted).

Recognizing the extension of Bailey set forth in Holmberg and discussed hereinabove and approvingly quoting Justice Frankfurter in Holmberg where the Justice quotes Bailey extensively and states that the equitable doctrine set forth in Bailey is read into every federal statute of limitation this Court states:

> This [Justice Frankfurter's statement that the Bailey rule is read into every federal statute of limitation] we take to mean that in cases of 'fraud' used to include at least instances of the kind at bar, when Congress does not choose expressly to say the

> contrary, the period of limitation set by it only begins to run after the injured party has 'discovered, or has failed in reasonable diligence to discover' the wrong. 191 F.2d 201 at 205.

The holding in Dabney should control here for the authority and principal upon which it is based are equally compelling today and the situation presented is so similar as to be dispositive of the issues presented herein. The statute of limitations at issue in Dabney designated an "adjudication" as the event from which the limitation runs. The statute at bar designates the "confirmation" as the event from which the limitation runs. Both statutes are limitations upon proceedings under the bankruptcy laws. The harsh effect of both statutes is mitigated by the rule in Bailey and the multitude of cases decided thereunder.

The rational and mitigating construction of statutes of limitation mandated by Bailey has been consistently applied by the federal courts in other contexts demonstrating the force of Bailey's authority and the continuing dominance of the principals upon which it is based. See Kansas City Missouri v. Federal Pacific Electric Co., 310 F. 2d 271 (8th Cir. 1962), cert. den. 371 US 912, 9 L.Ed. 2d 171, (the equitable doctrine enunciated in Bailey, supra, and extended in Holmberg, supra, applied to the statute of limitations for treble damages under § 4 of the Clayton Act); Accord: Movie Color Limited v. Eastman Kodak Co., 288 F. 2d 80 (2nd Cir. 1961), cert. den. 368 US 821, 7 L.Ed. 2d 26; City of Burlington, Vt. v. Westinghouse Electric Co., 215 F. Supp. 497 (D.C. Dist. 1963), aff'd 326 F. 2d 691 (D.C. Cir. 1964); Gaetzi v. Carling Brewing Company, 205 F. Supp. 615 (E.D. Mich. 1962); Janigan v. Taylor, 344 F. 2d 781 (1st

Cir. 1965) 382 US 987, 15 L.Ed. 2d 120, (equitable doctrine enunciated in Bailey, supra, and as extended in Holmberg, supra, applied to statute of limitations on an action under Securities and Exchange Act of 1934); Accord: Vanderboom v. Sexton, 422 F. 2d 1233 (8th Cir. 1970), cert. den. 400 US 852, 27 L.Ed. 2d 90; de Haas v. Empire Petroleum Co., 435 F. 2d 1233 (10th Cir. 1970); Parrent v. Midwest Rug Mills, Inc., 455 F. 2d 123 (7th Cir. 1972); See also Carpenter v. Hall, 311 F. Supp. 1099 (S.D. Tex. 1970) (Bailey applied to action under the Securities and Exchange Acts where defendants pleaded the statute of limitations set forth in § 11e of the Bankruptcy Act, 11 USC § 29e); Josef's of Palm Beach Inc. v. Southern Investment Company, 349 F. Supp. 1057 (S.D. Fla. 1972); Newburger, Loeb & Co., Inc. v. Gross, 365 F. Supp. 1364 (S.D.N.Y. 1973); Blau v. Albert, 157 F. Supp. 816 (S.D.N.Y. 1957). See also Tobacco & Allied Stocks v. Transamerica Corporation, 244 F. 2d 902 (3rd Cir. 1957) (Bailey read into statute of limitations applicable to an action by common stockholders of a subsidiary corporation against the parent corporation owning a majority of the subsidiary's stock for an accounting and the impressment of a trust upon the money and property resulting from the liquidation of the subsidiary corporation).

The Bailey rule, applied in virtually all federal actions should be applied by this Court. "[N]o man can take advantage of his own fraud"; Glus v. Brooklyn Eastern District Terminal, 359 US 231, 3 L.Ed. 2d 770(1959, Black, J.). This proposition coupled with the repeated judicial presumption that absent clear statutory language to the contrary, Congress

could not have intended such an inequitable and unjust result as to protect defrauders clever enough to conceal their fraud or a fraud sophisticated enough to conceal itself during the statutory period. In discussing the application of the Bailey rule to a statute of limitations upon Clayton Act violations the Eighth Circuit Court of Appeals stated:

> We are not pursuaded to believe that Congress meant to prescribe and outlaw conspiracies in restraint of trade only to reverse itself by enacting a statute of limitations that would reward successful conspirators. When the antitrust laws are violated, the wrongdoers who are successful in cloaking their unlawful activities with secrecy, through cunning, deceptive and clandestine practices should not, when their machinations are discovered, be permitted to use the shield of the statute of limitations to bar redress by those whom they have victimized. Kansas City, Missouri v. Federal Pacific Electric Co., supra, 310 F. 2d 271 at 284.

Similarly, at bar, defendants must not be permitted to take advantage of their wrongdoing by pleading the statute of limitations set forth in 11 USC § 786. The decision below construes § 786 as barring any exception. As demonstrated hereinabove, and as stated in City of Burlington, Vt. v. Westinghouse Electric Co., supra:

> Statutes of repose are by their nature absolute and yet it is not unusual that exceptions are read into them. 275 F. Supp. 497 at 503.

Citing the Supreme Court's wording in Exploration, supra and other cases, the Court continued:

> ... [S]omething more than mere absolute language must be shown before exceptions will be ignored. 215 F. Supp. 497 at 503.

Both MetPath and the Court below have shown nothing more than absolute language in support of the proposition that the Bailey rule does not apply. Upon controlling federal decisional law and judicial reasoning MetPath and the Court below are in error. This Court should so hold.

B. Medical's proceeding is an action based upon fraud for relief within the meaning of the authorities holding that statutes of limitation upon actions for fraud run from the discovery of the fraud.

For purposes of application of the Bailey rule, the Court below distinguished between an action for damages suffered as a consequence of fraud and an action brought under § 786 to set aside a confirmation in bankruptcy on grounds of fraud. Federal decisional law establishing the basis for application of Bailey, however, does not lend itself to this distinction. Indeed, an analysis of the relief sought in prior cases demonstrates that the rule in Bailey is applicable to a variety of actions seeking equitable relief and renders the lower court's distinction baseless. It is clear from the authority cited that Bailey is applicable to actions for equitable relief and to actions brought under the bankruptcy laws (or other enactments) which specifically designate an event from which the limitation should be measured. Beyond that, Bailey is applicable to actions for a diverse variety of equitable relief made necessary by a defendant's fraud. The diversity can be graphically demonstrated as follows:

Case	Relief sought
At Bar	Setting aside the confirmation of a plan of arrangement in bankruptcy procured by the fraud of an officer of the bankrupt.
Bailey	Setting aside a bankrupt's fraudulent conveyance of real estate.
Exploration	Annuling and vacating the issuance of a patent.
Holmberg	Enforcing liability under the Federal Farm Loan Act against a defendant who fraudulently concealed his ownership and interest.
Austrian	Accounting by bankrupt's former fidicuaries.
Dabney	Recovery of trust funds comprising part of the proceeds of a private settlement of a stockholder's derivative suit sought by the trustee in bankruptcy.

It is similarly clear from the authority cited that Bailey is applicable to any action based on fraud. In Bailey the Court stated that the rule is applicable whenever "the object of the suit is to obtain relief against a fraud." 88 US 342 at 347. In Exploration, the Court spoke of application to "suits to set aside fraudulent transactions." 247 US 435 at 449. In Holmberg the Court stated that Bailey applies where the plaintiff is "injured by fraud." 327 US 392 at 397. In Austrian the Court stated that Bailey applies when the suit seeks to obtain relief against a fraud. 80 F. Supp. 437 at 441.

Accordingly, Bailey is applicable to actions in equity such as the one at bar and for relief based upon the fraud alleged.

C. The District Court's reliance upon Collier's is misplaced and the authorities cited by the Court are inapposite.

The authorities cited by MetPath and the District Court are not persuasive. Collier's Treatise on Bankruptcy, cited and quoted by both MetPath and the District Court, states that the limitation set forth in 11 USC § 786 does not run from the date of the discovery of the fraud. Collier, Treatise on Bankruptcy, 2d Ed. 1973, Vol. 9 § 386 p. 592. The footnote which contains the authority on which Collier relies for that proposition, however, does not cite a single case. Rather, that footnote refers to the cases cited under § 15 of the treatise which discusses the provisions of the one-year Statute of Limitations for revocation of a discharge on the grounds of fraud in an ordinary bankruptcy proceeding, not 11 USC 786. For the proposition that the one year limitation on actions to revoke a discharge on the grounds of fraud in an ordinary bankruptcy proceedings runs from the date of the discharge Collier cites the following cases: In re Shaffer, 4 Am. B.R. 728, 101 Fed. 982 (D.C. N.C.); Mall & Co. v. Ullrich, 37 Fed. 653 (D.C. Ohio, 1888); In re Brown, Fed. Cas. No. 1,983, 19 N.B.R. 312 (S.D.N.Y. 1879); Pickett v. McGavick, Fed. Cas. No. 11,126 (D.C. Ark., 1876); In re Herzig, 16 Abb. New Cas. 179 (N.Y.).

Every one of these cases, cited principally for their applicability to the one year statute of limitations on an action to revoke a discharge in bankruptcy, (1) was decided before the Supreme Court's extension of the Bailey doctrine to all federal statutes of limitation in Holmberg (see p. 9 supra) and (2) is contrary to the holdings of the Supreme Court in Holmberg,

supra, and Exploration, supra, and to the decisions of this and other circuits regarding the continuing vitality of the Bailey doctrine. (See pages 13-14, supra).

In Exploration, supra, the defendant relied upon the express language of the applicable statute of limitations and cited In re Brown, supra; Pickett, supra; In re Herzig, supra and Mall & Co. v. Ullrich, supra, the cases upon which Collier rests his assertion that the limitation on an action to revoke a discharge on grounds of fraud runs from the date of discharge. The defendants in Exploration emphasized, as MetPath does herein, that the statutory language was not only explicit but inflexible. 247 US 437 at 441. The Supreme Court flatly rejected this contention and held that the Bailey doctrine applies to statutes expressly designating an event from which the limitation runs.

The basis for Collier's assertion has thus been rejected by the Supreme Court. This Court should do the same and reject Collier as a basis for the determination at bar.

The other authorities upon which MetPath relies in the Court below are similarly not dispositive of the issues at bar. MetPath relies principally upon the language of the Fifth Circuit in Solove v. Chase Manhattan Bank, 388 F. 2d 874 (5th Cir. 1968) in support of the proposition that the litigants' and the public's interest in the speedy disposition of bankruptcy matters prevails over the fraud-preventing purpose of a statute of limitation. Solove is distinguishable factually and on principal from the case at bar and this Court should not apply the Fifth Circuit's holding.

In Solove the Fifth Circuit denied a proposed amended petition to revoke a bankrupt's discharge filed more than one year after the discharge on the grounds that section 15 of the Bankruptcy Act, 11 USC § 33, provides that such applications must be filed within one year of the grant of the discharge. Neither the statute herein at issue nor the Bailey rule was discussed by the Court. The Court did discuss the interest of litigants and the public in a speedy disposition of the bankrupt's assets, but never addressed the difficult question of a balancing of those interests against the fraud-preventing purpose of statutes of limitation. In support of its holding, the Court discussed at length the purpose of the bankruptcy law to protect the bankrupt and to enable the bankrupt to "start over." Citing earlier cases, the Court stated that the "whole spirit and intent of the bankruptcy act ... is to give the bankrupt ... complete relief from further claims upon him so that he may start over again." 388 F. 2d 874 at 877. Accordingly, it refused to permit the filing which would have been in derogation of the bankrupt's interest. By contrast, MetPath seeks a reading of 786 which would insure the demise of the bankrupt by nailing its coffin forever closed. The fraud of the bankrupt corporation's officers and MetPath (who obtained Medical's principal assets) by means of which the confirmed Plan was obtained, operates so as to render the corporation totally insolvent and incapable of "starting over." This Court should not read 786 so as to accomplish an end which so perverts the purpose of the bankruptcy laws.

The other authorities cited by MetPath below similarly fail to buttress their argument. In re Graco, Inc., 267 F. Supp. 952 (D.C. Conn., 1967) is patently inapposite. In Graco the petition to set aside a confirmation in bankruptcy was dismissed because no fraud was alleged. In the Court's words:

> No fraud is alleged to have tainted the arrangement; indeed, the movant's attorney specifically disclaimed the existence of any fraud. 267 F. Supp. 952 at 954.

Similarly the Seventh Circuit in In re Light & Company, 193 F. 2d 313 (7th Cir. 1943) was not presented with the issue of whether § 786 bars an action to set aside an arrangement on grounds of fraud. The Court in In re Light & Company determined the issue of whether the Bankruptcy Court has the power to restrain state court proceedings for an accounting and other relief arising out of a previous composition.

In In re Crusader Oil Refining Corporation, 47 F. Supp. 873 (D.C. N.J., 1942), the Court dismissed the proceeding on the ground that the petitioner (1) did not demonstrate an interest sufficient to bring the petition and (2) failed to allege that petitioner learned of the fraud after the confirmation of the arrangement. The Court did not reach the issues raised at bar.

Whiteford Plastics Co. v. Chase National Bank of New York City, 179 F. 2d 582 (2nd Cir. 1950) was a determination rendered upon a petition brought under 11 USC §§ 742 and 110 subd. e to set aside a conditional sale. The only mention in Whiteford Plastics of § 786 is that the petition therein was not brought pursuant to § 786. The case is clearly illustrative of nothing insofar as the case at bar is concerned.

Accordingly, upon substantial abundant controlling federal decisional law , MetPath and the Court below are in error. This Court should so hold and Medical's petition should proceed to determination.

D. Equitable principals articulated by the federal courts require that a statute of limitations applicable to an action based upon fraud be held to run from discovery of the fraud.

The federal courts have repeatedly stressed the salutary fraud-preventing legislative purpose impelling statutes of limitation. These statutes are designed to bar plaintiffs from commencing actions after evidence demonstrating that claims have been satisfied, transferred or extinguished has been destroyed, impaired or never existed. See Bailey, supra, 22 L.Ed. 636 at 638.

Statutes of limitations are therefore principally designed to prevent fraud. Under the controlling principals of federal law set forth supra, and in light of the legislative purpose of such statutes, they should not be applied so as to insulate defendants from challenge on the grounds of fraud.

Both the Supreme Court and this Court have repeatedly stated that statutes of limitation, whose purpose is to prevent fraud, should not be used to protect it. In Dabney, supra, upon applying the Bailey rule to an action based upon fraud and otherwise barred by an explicit statute of limitations read into the bankruptcy law, this Court stated:

> [I]t would be monstrous if so bare-faced a taking of this corporation's funds as is here displayed were to escape restitution

> because the confederates had succeeded in keeping the transaction from detection for six years. [The time within which an action must be brought set forth in the applicable bankruptcy law's statute of limitations.] 191 F. 2d 201 at 205.

In Bailey, supra, the Supreme Court recognized that one of the purposes of the bankruptcy laws is "that there should be a speedy disposition of the bankrupt's assets." 88 US 342 at 346. Balancing this purpose of the bankruptcy laws against the fraud-preventing purpose of statutes of limitation, the Court deemed the fraud-preventing purpose of the statutes of limitation of controlling significance and formulated the Bailey doctrine upon which Medical relies. The Court stated:

> ... To hold that by concealing a fraud, or by committing a fraud in such a manner that it concealed itself until such time as the party committing the fraud could plead the Statute of Limitations to protect it, is to make the law which was designed to prevent fraud, the means by which it is made successful and sincere. 88 US 342 at 349.

This preposterous inequity the Supreme Court disallowed. The Court's reasoning is as compelling today and this Court should similarly not allow such a result at bar. Indeed, the principal so articulated is even more compelling at bar where the statute's limitation is a mere six months. Many such frauds could be concealed or could conceal themselves for such a short time. This is especially true where, as at bar, the defrauders are in a fiduciary relationship to the plaintiffs. The law does not require, nor should it expect, one to suspect a fiduciary so as to discover a fraud in such a short time. Cf. Amen v. Black, 234 F. 2d 12 (4th Cir. 1944) ("[T]he law does not require one to suspect his fiduciary." 234 F. 2d 12 at 26).

The policy considerations articulated by the Supreme Court and this Court for impelling application of the Bailey rule apply with equal force at bar. On balance, Medical's access to the courts to redress fraud herein and denial of the use of statutes designed to prevent fraud to those who would pervert the statutory purpose so as to render those statutes a fraud-protecting mechanism, outweigh the bankruptcy law's purpose to speedily dispose of the bankrupt's assets.

MetPath's suggestion to the Court below that the federal courts should relegate Medical to a plenary action in the state courts on common law fraud grounds is tantamount to a suggestion that Medical be denied any remedy at all. Medical here seeks the only remedy available to procure its health and restoration. To force Medical to await trial in the state courts on common law fraud would deny Medical any remedy -- while awaiting trial Medical would be economically deteriorating. Moreover, because of the financial position to which Medical has been reduced as a direct result of the fraud alleged, Medical would be unable to afford the expenses of such lengthy and costly state court litigation.

Since Bailey was in full force and effect at the time of enactment of the statute at issue, absent a specific Congressional mandate barring the application of the rule to proceedings such as the one at bar, Bailey controls. Since Medical commenced this suit three months after discovering the fraud, the six month statute of limitation set forth in 11 USC 786 does not bar this action.

As stated by the Fourth Circuit Court of Appeals in denying defendants' argument that the appropriate statute of limitation barred claims by various petitioners that specified trustees in bankruptcy had fraudulently compiled an inadequate report pursuant to section 167 of the bankruptcy act, and that a reinvestigation and new report was necessary:

> Where a corporation which is alleged to have been greatly wronged by those who have controlled it has sought the haven of the bankruptcy court, the court ought not lightly stay its hand against those who have committed the wrong, on the ground that they might plead a statute of limitations which honorable men might not be willing to plead and which others might plead in vain. Committee for Holders of Central States Electric Corporation 7% Cumulative Preferred Stock v. Kent, 143 F. 2d 684 at 687 (4th Cir. 1944).

CONCLUSION

For all the foregoing reasons, the lower courts order dismissing Medical's petition should be reversed and an order should be entered directing Medical's petition to proceed to determination.

Respectfully submitted,

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Of Counsel

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Barbara L. Schulman

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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In the Matter of

MEDICAL ANALYTICS,

Debtor.

Docket No. 76-5001

AFFIDAVIT OF SERVICE
OF BRIEF AND APPENDIX

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State of New York)
:
County of New York)

Clara Rocco, being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 384 Broome Street, New York, N.Y. 10013; that on the 27th day of February, 1976, deponent served two copies of the Brief for Appellant and one copy of the Joint Appendix upon each of the following:

1. Raymond Rose
MetPath, Inc.
60 Commerce Way
Hackensack, N.J. 07606

2. Louis Rosenberg
16 Court Street
Brooklyn, N.Y.

3. Fisher Hecht & Fisher
200 Park Avenue South
New York, N.Y.

by depositing true copies of the same enclosed in a post-paid properly addressed wrapper, in an official depositary under the exclusive care and custody of the United States Post Office Department within the State of New York.

Clara Rocco
Clara Rocco

Sworn to before me this
27 day of February, 1976

Barbara Lee Schulman

BARBARA LEE SCHULMAN
Notary Public, State of New York
No. 31-4518528
Qualified in New York County
Commission Expires March 30, 1976

Docket No. 76-5001

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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AFFIDAVIT OF SERVICE OF
BRIEF AND APPENDIX

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By E. Duathworth

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